Supreme Court of the United States

OCTOBER TERM 1948.

No. 269

ANTONIO RULLÁN, *Petitioner,*

v.

RAFAEL BUSCAGLIA, *Treasurer of Puerto Rico, Respondent.*

PETITION FOR WRIT OF CERTIORARI AND SUPPORTING BRIEF.

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PETITION.

To the Honorable The Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, Antonio Rullán, through his undersigned attorneys, prays issuance of a writ of certiorari to the United States Circuit Court of Appeals for the First Circuit, to review the judgment entered June 14, 1948, in Docket Number 4310 of that court, October Term, 1947, affirming a judgment rendered by the Supreme Court of Puerto Rico on July 9, 1947.

SUMMARY SHORT STATEMENT.

On grounds of both local and federal law, petitioner challenges the validity of a deficiency assessment of $9,092.18, with interest at 6% per annum from March 15, 1943, imposed by the respondent against the petitioner upon the latter's insular income tax return for 1942.

The controversy turns upon the correct interpretation and application of the following provisions of subsection 16(a) of Act No. 74, approved August 6, 1925 (Laws of P. R., 1925, pp. 400, 438), as amended by Act No. 31, approved April 12, 1941 (Laws of P. R., 1941, pp. 478, 494-496), to-wit (italics supplied to indicate words inserted by Act No. 31):

> "Section 16(a) In computing net income there shall be allowed as deductions:"
>
> * * * *
>
> "(2) All interest paid or accrued within the taxable year on indebtedness" * * * *"Provided, That no interest is deductible if it is payable between members of one family"* * * *

For parts omitted from the foregoing quotation, see Appendix A, *infra,* pp. 42-43.

More specifically the question at issue here is whether accrued interest due and actually paid by the petitioner to his brothers during 1942 on genuine obligations contracted mostly in 1940, was legally deductible in the computation of net income on petitioner's insular income tax return for 1942.

For reasons more fully set forth in the supporting brief (*infra,* pp. 9-41), petitioner has maintained from the beginning that the foregoing question can reasonably be answered only in the affirmative, that according to its literal terms and context the proviso of subsection 16(a)(2), inserted in 1941, and italicized in the foregoing quotation, clearly was intended by the legislature to prohibit the de-

duction only of accrued interest remaining *payable* at the end of the taxable year on obligations to relatives, and that the contrary interpretation would not only violate fundamental rules of statutory construction made mandatory in Puerto Rico by local statutes, but would render the taxing statute so unjustly discriminatory, arbitrary, capricious and confiscatory as to violate the due process, equal protection and uniformity of taxation guaranties of Section 2 of the Organic Act of Puerto Rico (39 Stat. 951; 48 U. S. C. 737).

In harmony with that view, when computing his net income upon his tax return for 1942, petitioner included among his deductions the amounts of his interest payments to his brothers during that year, aggregating $16,153.79, of which the bulk ($14,933.32) represented interest on the obligations contracted in 1940, before the proviso of 1941 was enacted (R. 48-49, 72). The transactions were genuine. The interest was properly due and owing when paid, and was duly reported by the payees upon their respective insular income tax returns for 1942. These facts are not in dispute (Op. Tax Court, R. 19-20; Op. insular Supreme Court, R. 28; Op. Circuit of Appeals, R. 76).

On September 1, 1944, respondent disallowed the interest deductions, recomputed the tax on that basis, and assessed the deficiency in question, pursuant to his theory that the quoted statute prohibits such deductions, regardless of the genuineness and good faith of the basic transactions (R. 4-10).

After a prompt application to respondent for reconsideration, denied a year later on September 18, 1945, petitioner in October of that year appealed to the Tax Court of Puerto Rico, contending both that the deductions were authorized by the plain and express terms of the statute, and that the additional tax demanded was violative of the uniformity, due process and equal protection clauses of the Organic Act (R. 4-7).

The Tax Court on September 6, 1946, sustained the petitioner's position in all particulars, holding in substance that the purpose of the proviso of subsection 16(a)(2), was like that of the corresponding parts of the United States income tax laws from which it was derived, that is, to prevent evasions of tax liability through juggling of accounts of unpaid interest alleged to have accrued between persons within the specified categories (R. 10-21).

Respondent then took the case to the Supreme Court of Puerto Rico by certiorari, alleging in his petition in substance simply that the Tax Court had erred in construing the statute to authorize the taxpayer to deduct the "amounts which he paid to his brothers as interest," and praying reversal (R. 1-3).

Although agreeing fully with the Tax Court as to the reality and good faith of the transactions and interest payments in question, and declaring that the controversy centers solely on the question whether such payments are deductible under the terms of the statute, the insular Supreme Court on July 9, 1947, reversed the Tax Court, making no mention of the federal questions raised by petitioner, and holding in substance that the words "if it is payable" in the proviso of subsection 16(a)(2) are equivalent to "if it was paid or is payable" (R. 26-30).

Petitioner moved for reconsideration, again urging especially the federal questions involved (R. 30-37), and upon denial of that motion (R. 37), appealed to the United States Court of Appeals for the First Circuit, specifying the same points of local and federal law raised by him in the lower courts, being the same which are now presented here (R. 38-39).

By its opinion and judgment of June 14, 1948, review of which is here sought, the Circuit Court of Appeals affirmed the judgment of the insular Supreme Court (R. 75-82).

JURISDICTION.

This being a civil cause in a circuit court of appeals, this court is clearly empowered to grant this petition, either by section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (43 Stat. 938; 28 U. S. C. 347), or by the corresponding section 1254 of the new Title 28, United States Code, enacted by the Act approved June 25, 1948, effective September 1, 1948 (Pub. Law 773, 80th Congress, Second Session).

Since the date of the judgment of the Court of Appeals, review of which is hereby sought, is June 14, 1948, the period of three months allowed by section 8(a) of the Act of February 13, 1925 (43 Stat. 940; 28 U. S. C. 350) for filing this petition extends to September 14, 1948, while the ninety days allowed therefor by the corresponding section 2101 of the new Title 28, United States Code, enacted by the Act approved June 25, 1948, effective September 1, 1948 (Pub. Law 773, 80th Congress, Second Session), expires September 12, 1948.

QUESTIONS PRESENTED.

Local Law.

1. Whether the Supreme Court of Puerto Rico erred patently and inescapably, as a matter of local law, in holding that subsection 16(a) of Act No. 74 of August 6, 1925, as amended by Act No. 31, approved April 12, 1941, prohibits the deductions in question.

Federal.

2. Whether the uniformity of taxation clause of the Puerto Rican Organic Act, providing "That the rule of taxation in Puerto Rico shall be uniform" (Sec. 2, Act of March 2, 1917, 39 Stat. 951, 48 U. S. C. 737), requires intrinsic as well as geographic uniformity.

3. Whether the statute as interpreted and applied by the respondent in this case violates the due process, equal protection or uniformity of taxation clauses of Section 2 of the Organic Act of Congress for Puerto Rico (Act of March 2, 1917; 39 Stat. 951; 48 U. S. C. 737).

REASONS FOR GRANTING THE WRIT.

The error and grave injustice of the judgments of both lower appellate courts are patent and inescapable. See Supporting Brief, *infra*, pp. 9-41.

This is not a controversy over the meaning of an ambiguous statute, reasonably susceptible of two or more interpretations. The statute here is clear and unambiguous. Literally, and with regard to the issue here involved, it can reasonably mean but one thing. Yet it has been interpreted by the lower appellate courts to mean something quite different—something directly opposite to the ordinary meaning of its words—without the citation by either of those courts of any tangible or logical reason for so doing. Indeed there is no logical reason. That interpretation is a flagrant example of judicial legislation.

Only this court can now repair the error. In the proper exercise of its supervisory powers and duties, this court should grant review by certiorari to guard against what must appear to its members, even from only a preliminary examination of the case, to be at least a strong possibility, if not a probability that it involves thus far a manifest and gross miscarriage of justice.

Further reasons for granting the requested review arise from the holdings of the Circuit Court of Appeals that the statute, so interpreted, does no violence to the due process, equal protection or uniformity of taxation guaranties of the Puerto Rican Organic Act. Those holdings comprise decisions of important questions of federal law which have not been, and should be, decided by this court.

The questions are vitally important to the people of Puerto Rico, because they bear on the extent to which

individual residents of that territory are protected against capricious, unfair, unequal, discriminatory or confiscatory local taxation.

Among those questions is the especially important one whether the uniformity of taxation clause of the Organic Act of Puerto Rico requires both intrinsic and geographic uniformity. It seems fairly clear that if the clause requires intrinsic uniformity, it is violated by the statute here involved, as construed below, because it would require Antonio Rullán to pay over $9,000 in taxes on income that would not be taxed at all to another under circumstances precisely similar in all material respects.

The Circuit Court of Appeals again in this case adhered to its prior opinion in *Ballester-Ripoll* v. *Court of Tax Appeals* (1944), 142 F. 2d 11, that the uniformity of taxation clause of the Organic Act requires only geographic uniformity, and thus affords no protection whatever against even the most flagrant intrinsic disparity of taxation between taxpayers in like circumstances.

Counsel for petitioner contend that this ruling is clearly wrong, and that the prior view of the same court, to the effect that intrinsic disparities also violate the clause, as exemplified in *Domenech* v. *Havemeyer,* 49 F. 2d. 849, is correct. See Supporting Brief, *infra,* pp. 28-32.

In any event, as above suggested, it is apparent that this federal question, like those concerned with the validity of the taxing statute, as interpreted by the lower appellate courts, under the due process and equal protection clauses of the Organic Act, is one of real and vital importance to Puerto Rico, likely to recur in Puerto Rican tax litigation, until finally settled by this court.

CONCLUSION OF PETITION.

For the reasons outlined above, and more fully discussed in the appended brief, this petition should be granted, and upon due hearing and consideration the judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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September 10, 1948.

Supreme Court of the United States

OCTOBER TERM 1948.

No.

ANTONIO RULLÁN, *Petitioner,*

v.

RAFAEL BUSCAGLIA, *Treasurer of Puerto Rico, Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals is reported in Volume 168 Federal Reporter, Second Series, pages 401-404, and appears in the Transcript of Record beginning at page 75.

The opinion of the Supreme Court of Puerto Rico is not yet officially reported in English; but the English text is in the Transcript of Record beginning at page 26.

The English text of the opinion of the Tax Court of Puerto Rico is in the Transcript of Record beginning at page 10.

JURISDICTION.

See Petition, *supra,* p. 5.

STATEMENT OF THE CASE.

See "Summary Short Statement," Petition, *supra*, pp. 2-4.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred:

(1) In failing to reverse the judgment of the Supreme Court of Puerto Rico upon the ground that the judgment is patently erroneous and inescapably wrong as a matter of local law.

(2) In failing to reconsider and overrule its prior holdings that the uniformity of taxation clause of the Puerto Rican Organic Act requires only geographical and not intrinsic uniformity.

(3) In failing to hold that the interpretation of subsection 16(a) of Act No. 74 as amended, advocated by the respondent and upheld by the Supreme Court of Puerto Rico, is barred by the due process, equal protection and uniformity of taxation clauses of the Organic Act for Puerto Rico.

STATEMENT OF POINTS AND SUMMARY OF ARGUMENT.

(1) Subsection 16(a) of the Income Tax Act (No. 74 of Aug. 6, 1925, Laws of P. R., 1925, pp. 400, 438), as amended by Act No. 31 of April 12, 1941 (Laws of P. R., 1941, pp. 478, 494, 496), expressly authorizes the deductions in question, and the Supreme Court of Puerto Rico erred patently and inescapably, as a matter of local law, in holding otherwise. See Point I, *infra*, pp. 11-28.

(2) The uniformity of taxation clause of the Puerto Rican Organic Act requires intrinsic uniformity. See Point II, *infra* pp. 28-32.

(3) The deficiency tax in question is unjustly discriminatory, arbitrary, capricious, confiscatory, and thus repugnant to the due process, equal protection and uniformity of taxation guaranties of the Puerto Rican Organic Act. See Point III, *infra*, pp. 32-41.

ARGUMENT.

Point I.

The Judgments of the Supreme Court of Puerto Rico and of the Circuit Court of Appeals Are Patently and Inescapably Wrong as a Matter of Local Law.

Referring to the pertinent part of the text of subsection 16(a) (*supra*, p. 2), and particularly to the 1941 proviso thereof shown in italics, the dispute is over the intent of the word "payable", or more properly the phrase "if it is payable".

Respondent contends that the legislature intended by this proviso to prohibit the deduction of interest actually paid out by the taxpayer during the taxable year to any member of his own family, as well as interest accrued but remaining payable to such a member at the end of taxable year; and respondent has been upheld in that view by both the insular Supreme Court and the Circuit Court of Appeals. In that view the phrase "if it is payable", becomes equivalent to "if it was paid or is payable."

Petitioner's position briefly stated is that the language of the statute is clear and unambiguous, that taken literally and with due regard to its context it can be understood to relate only to accrued interest, that is interest accrued but remaining unpaid at the end of the taxable year, and that the statute is not reasonably susceptible of any other interpretation, because there is nothing anywhere to indicate that the legislature used the words in any other than their ordinary literal sense.

An important factor supporting the petitioner's view is that the phrase "if it is payable" must logically be taken to relate to the end of the taxable year. This is convincingly established by the introductory clause of subsection 16(a), providing that it is "In computing net income" that the subsequently specified deductions are allowed, and of subdivision (2) specifying: "All interest paid or accrued within the taxable year." Since that computation can be

made only after and with relation to the end of the taxable year, it is necessarily with relation to the end of the taxable year that the words "if it is payable" are employed.

When inserting the qualifying proviso under consideration, by the Act of April 12, 1941, the legislature reenacted the entire section 16, with the desired amendments, including the proviso in question as an addition to subsection 16(a)(2). Thus, when enacting the proviso, the legislature had directly before its eyes the retained preceding text of the subsection, authorizing the deduction of "All interest *paid or accrued* within the taxable year", in which the word "accrued" can only mean "accrued and unpaid", because otherwise that word obviously would be wholly superfluous.

It is manifestly unreasonable to suppose that the legislature, if it had intended as suggested by the Court of Appeals to "match the exclusion to the grant", and bar the deduction of both interest actually paid, and interest accrued and unpaid but remaining payable, would have included in the proviso reference only to interest "payable". Had the legislature so intended it could easily have made that intent plain beyond question by simply repeating in the excepting proviso the same words employed in the preceding retained text of the granting proviso, making it read: "Provided, that no interest is deductible if it is paid or accrued," etc. That it did not do so, or otherwise evidence such an intent in any way, shows convincingly that it did not so intend.

The insular Supreme Court offers no tangible grounds for its contrary view. Its conclusion on the point is blunt and unreasoned. That court simply declares (R. 29):

> "The fact that the statute uses the term *payable* does not have, in our judgment, the restrictive scope which the Tax Court placed thereon. The purpose of the Legislature was to disallow the deduction of interest which passed from one member of a family to another. The fact that instead of using the word *paid* it used the term *payable* does not change the situation."

One fundamental and inescapable error in that statement lies in the fact that the adjective *payable,* when employed in such a context, by virtue of definition and usage, always necessarily means "due or accrued and unpaid," or "capable of being paid," or "to be paid," and could never properly be so employed to refer to any debt or obligation already paid. The truth of this statement can be verified by reference to any standard English dictionary, for example, Funk & Wagnalls New Standard Dictionary of the English Language, Edition of 1945; although we presume this court will take judicial notice that the ordinary meaning and usage of the word are as above stated.

Nor does the adjective *pagaderos,* which appears in the official Spanish version of the statute in question where payable is used in the corresponding English text, afford any support whatever for the construction adopted by the insular Supreme Court. *Pagaderos* is the masculine plural form (in this instance qualifying and agreeing with *intereses,* i.e. *interests*) of the adjective *pagadero,* which, in such a context as that here in question, is precisely equivalent to the English *payable,* and is never so employed in relation to obligations already paid. *Diccionario de la Lengua Espanola,* 16th Ed., 1939; *The New Valasquez Dictionary, Spanish-English; Martinez Amador English-Spanish Spanish-English Dictionary, 1946.*

In short, interest which has been paid cannot be described as payable, because such a description would manifestly be self-contradictory. It would amount to saying interest paid is interest unpaid.

That the Puerto Rican Legislature has uniformly understood and employed the word "payable" and its Spanish equivalents, only in reference to unpaid obligations, is apparent from its enactments. An extensive search of the session laws of that body has failed to disclose a single instance of the use of the word "payable" to describe any obligation already paid at the time to which the word relates. Wherever the word appears in any insular statutory

provision, so far as we have been able to discover, the context clearly shows that it relates to obligations unsatisfied at the time or times to which the provision refers.

For example, in the same Income Tax Act No. 74 of 1925, *supra*, with subsection 16(a)(2) of which, as amended by Act No. 31 of 1941, *supra*, we are most directly concerned in this case, attention is invited to section 43(a)(3), as amended by the same amendatory Act No. 31 (Laws of P. R., 1941, pp. 526, 528-529), providing in pertinent part (italics supplied):

> "Section 43.—(a) In the case of a life insurance company the term 'net income' means the gross income less—
>
> • • • • •
>
> "(3) An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than *dividends payable during the year following the taxable year*) • • •"

It will be observed from the parallel official Spanish text on page 529, that the Spanish words corresponding to "dividends payable" are "*dividendos pagaderos,*" and from both contexts that they definitely exclude any possible reference to dividends actually paid prior to the end of the taxable year.

Other examples of the employment of the same words by the insular legislature, showing their uniform use by that body to describe only unpaid obligations, are in Appendix B, *infra*, pp. 44-49.

We return to the above quoted language of the insular Supreme Court (*supra*, p. 12), and particularly the statement that the purpose of the legislature in the proviso of subsection 16(a)(2) was to disallow the deduction of interest "which passed" from one member of a family to another. The court offers no explanation whatever for that bald conclusion, and we think it manifest that no such conclusion can reasonably be drawn from the language or context of the subsection in question, or from the whole section, or the whole act.

Subsection 16(a)(2) starts with a provision allowing generally the deduction from gross income of "all interest *paid or accrued* within the taxable year," with minor exceptions not pertinent here. That part of the subsection was copied verbatim from Section 214(a)(2) of the Federal Revenue Act of June 2, 1924 (43 Stat. 253, 270), and has remained unchanged in both the federal and Puerto Rican income tax acts down to this date (26 U. S. C. 23*b*).

In 1937, in the light of experience disclosing evasions of tax liabilities by means of fictitious or abnormal transactions between closely related persons, involving incurred or accrued and unpaid expenses and interest, and for the purpose of preventing such evasions, the Congress inserted in the federal income tax law certain provisions as follows [Act of August 26, 1937, Sec. 301; 50 Stat. 828; 26 U. S. C. 24(c)]:

> "UNPAID EXPENSES AND INTEREST.—In computing net income no deduction shall be allowed in respect of expenses incurred under section 23(a) or interest accrued under section 23(b)—
>
> "(1) If not paid within the taxable year or within two and one half months after the close thereof; and
>
> "(2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and
>
> "(3) If, at the close of the taxable year of the taxpayer or at any time within two and one half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under section 24(b)."

The persons between whom losses would be disallowed under section 24(b), include, among others, members of a family, and that section, for its purposes, defines the family of an individual as including the individual's brothers

and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants (26 U. S. C. 24(b)).

That the federal statutory provision last above quoted was intended to apply only to *interest payable,* that is, *interest due or accrued but unpaid within the taxable year or within two and one-half months after the close thereof,* and not to *interest actually paid during that period,* is made clear beyond all question by the capitalized heading as well as the explicit terms of the provision. Moreover, as pointed out by the Tax Court in this case (R. 18-19), and tacitly conceded by the insular Supreme Court (R. 27), it has uniformly been so construed by the Bureau of Internal Revenue and the federal courts. Law of Federal Income Taxation, Mertens, Vol. 4, Section 26.02, page 536.

The proviso of subsection 16(a)(2) of the Puerto Rican Income Tax Act, with which we are here concerned, was inserted therein by Act No. 31 of April 12, 1941, *supra,* less than four years after the above quoted provisions were placed in the corresponding federal law. The proviso incorporates the substance of the corresponding federal provisions above quoted. It is reasonable to conclude that the insular legislature, in enacting the proviso, was only following the lead of the Congress, and that the purpose of the proviso was substantially the same as that of the quoted federal enactment, that is, simply to guard against evasions of normal tax liabilities through juggling of incurred or accrued and unpaid expenses and interest.

True the legislature did not choose to copy precisely the wording of the federal statute on the subject, or to adopt all of its details, such as the extension of two and one-half months beyond the end of the taxable year for payment, or the detailed regulation respecting methods of accounting. However, the legislature did, by its express reference in the proviso to "interest * * * payable," indicate very definitely that it was, like the Congress in its preceding similar action, dealing only with interest accrued and remaining unpaid at the close of the taxable year, and did not mean

to forbid deductions of interest actually paid in good faith on genuine obligations during the taxable year.

The patent and inescapable nature of the error of the insular Supreme Court's interpretation of the statute in question is further shown by consideration of cardinal rules of statutory construction ignored and violated by the court in its conclusion above quoted.

It is true that the primary rule of statutory construction is to ascertain and give effect to the purpose of the enactment. However, essential corollaries are that the best evidence of the intent or purpose of a statute or statutory provision is to be found in its own wording, that the words are to be taken in their ordinary meaning unless a different meaning is clearly indicated, and that where the words are clear, unambiguous and sensible in result, they must be construed literally to mean what they say.

In short, the most persuasive evidence of the purpose of a statute lies in the words by which the legislature gives expression to its intentions. Where those words are sufficient in themselves to determine the purpose of the enactment, the courts follow their plain meaning. *Van Camp & Sons* v. *American Can Co.*, 278 U. S. 245, 253, 49 S. Ct. 112, 73 L. Ed. 311; *United States* v. *Missouri Pacific R. Co.*, 278 U. S. 269, 278, 49 S. Ct. 133, 73 L. Ed. 322; *Crooks* v. *Harrelson*, 282 U. S. 55, 60, 51 S. Ct. 49, 75 L. Ed. 156; *Wilbur* v. *United States*, 284 U. S. 231, 237, 52 S. Ct. 113, 76 L. Ed. 261; *Helvering* v. *City Bank Co.*, 296 U. S. 85, 89, 50 S. Ct. 70, 80 L. Ed. 62; *Taft* v. *Commissioner*, 304 U. S. 351, 359, 58 S. Ct. 891, 82 L. Ed. 1393.

In Puerto Rico those principles are statutory, the insular Civil Code providing expressly (Edition of 1930, page 5):

> "Section 14.—When a law is clear and free from all ambiguity, the letter of the same shall not be disregarded, under the pretext of fulfilling the spirit thereof.
>
> "Section 15.—The words of a law shall generally be understood in their most usual signification, taking

into consideration, not so much the exact grammatical rules governing the same, as their general and popular use."

Furthermore, the general rule requiring adherence to the letter of a plain and unambiguous statute, applies with special force to taxing acts. *United States* v. *Merriam*, 263 U. S. 179, 187-188, 44 S. Ct. 69, 68 L. Ed. 240; *Crooks* v. *Harrelson, supra*, at p. 61.

Yet, in the present case, the insular Supreme Court casts aside the plain and customary meaning of the wording of the proviso in question, construes the word *payable* to mean both *paid* and *payable*, and offers no explanation whatever for this radical departure from the established principles above cited. We are left entirely to conjecture as to why that court concluded that the legislature meant by this proviso, despite its contrary literal significance, to withdraw from taxpayers the right to deduct from gross income interest actually paid during the taxable year in good faith on genuine indebtedness to relatives.

Was there something in the general purpose of the whole act that would support such a conclusion? The insular Supreme Court points to none. The Circuit Court of Appeals mentions none. We find none. The general purpose of the Puerto Rican income tax laws, like those of the United States and most of the states, obviously is to raise revenue for governmental purposes through the imposition of taxes on net income, so defined and conditioned as to distribute the burden fairly among the taxpayers.

A feature common to almost all of these income tax laws, has been their general authorization of the deduction of interest paid or accrued during the taxable year on indebtedness of the taxpayer. The provision obviously is everywhere designed to achieve part of the incidental purpose of fairness and uniformity in the distribution and application of the tax burden with regard to actual net income. And it is obvious, from its text and context, that such is the general purpose of subsection 16(a)(2) of the Puerto Rican

income tax act. Certainly nothing in that subsection, or its purpose, or context, affords the slightest reason for construing the proviso against the plain import of its language, to be applicable to interest actually paid during the taxable year. On the contrary, it is readily apparent that such a construction would *pro tanto* defeat the basic purpose of the subsection, by arbitrarily and unjustly denying to some taxpayers the right to deduct bona fide interest payments actually made during the taxable year, while continuing to permit the great majority in like circumstances to deduct all such payments, with only minor exceptions not significant here.

Moreover, the construction of section 16(a)(2) adopted by the insular Supreme Court and affirmed by the Court of Appeals also tends to defeat *pro tanto* the basic purpose of the taxing statute to tax only *net income*. The point we make here is well illustrated by *Wallace* v. *Commissioner of Internal Revenue*, 114 F. 2d 407.

In that case the Commissioner had disallowed deductions from gross income, claimed by the taxpayers (a husband and wife domiciled in San Francisco, California), under section 23(a)(1) of the Internal Revenue Code, of traveling expenses of the wife including amounts expended for food, rent and similar living expenses at Hollywood, California, while she was employed there during 1939 as a motion picture actress. The Tax Court of the United States upheld the disallowance, approving the Commissioner's interpretation of the word "home," as used in the mentioned section, to include the taxpayer's place of business, employment, post or station, and affirming his ruling that Mrs. Wallace had not been away from "home" in the sense of the code provision, and thus was not entitled to the deductions claimed.

The Ninth Circuit Court of Appeals reversed, holding in substance that the statutory provision in question was clear and unambiguous; that there was nothing in it, or its context, or any cognate act, denoting any intention by Con-

gress to attribute to the word "home," as used in the provision, any unusual or novel meaning; that Hollywood did not at any time during 1939 become Mrs. Wallace's home in the ordinary meaning of that word, and that the taxpayers were lawfully entitled to the deductions claimed.

However, the part of the opinion in that case which we regard as especially significant and important in the immediate connection, is as follows (144 F. 2d 411):

> "[6] The clearly expressed purpose of Congress in enacting income tax laws is to impose tax burdens upon the *net income* of individuals, and in ascertaining such income when Congress has used only literal terms in specifying the allowable deductions from gross income such meaning of deductions must be accepted by the courts unless such course would lead to absurd results. We can conceive of no such results by giving to the word 'home' in the application of section 23(a)(1) of the Internal Revenue Code its normal and customary meaning. On the other hand to judicially innovate a meaning of 'home' as the taxpayer's 'place of business, employment, or the post or station at which he is employed,' as the Tax Court has done, would, we think, operate to thwart the obvious purpose of Congress to tax *net* income and would in many cases tax the gross instead of the net income of individuals."

To the same effect is *Flowers* v. *Commissioner*, 148 F. 2d 163, reversed on other grounds, 326 U. S. 465, 66 S. Ct. 250, 90 L. Ed. 203. This court expressly reserved decision upon the question of the meaning of "home" which, however, was fully discussed by Mr. Justice Rutledge in a dissenting opinion emphatically expressing views substantially like those of the Ninth Circuit Court of Appeals above quoted (326 U. S. 474-480).

It follows that all attempts to devise a plausible hypothesis justifying construction of the proviso in question as applicable to interest actually paid, fail completely.

On the other hand, the construction of the proviso to mean just what it says according to the usual acceptance

of its words, and thus to have no application to interest actually paid under such circumstances as those disclosed by the record in this case, is in full harmony with the basic purposes of the whole enactment as well as the section and subsection in which it appears.

In reaching its contrary conclusion, the First Circuit Court of Appeals, like the insular Supreme Court, fails to assign any logical reason therefor.

Declaring that it cannot agree with so narrow a connotation as that placed upon the word "payable" by the petitioner, the court first sweeps aside all the recognized authorities on the ordinary literal significance of that crucial word, stating that the definitions of the word in dictionaries, and its "supposed" equivalence to the Spanish word "*pagadero*" shed little light on the problem (R. 77; 168 F. 2d 402).

This seems to amount to a holding that the ordinary meaning and usage of its wording and context is of little or no consequence in a judicial determination of the intent of the statutory proviso in question. Such a holding is in direct conflict with the fundamental principles of statutory construction above cited (*supra*, pp. 17-18). The very best evidence of the intent of a legislative provision is to be found in the words employed therein. If the words, according to their usual meaning, make good sense, and are not in conflict with the spirit or purpose of the enactment, they must be given that meaning unless there is definite evidence of a different intent.

Next the Circuit Court of Appeals concedes that interest which has already been paid is not carried on books of account as interest payable, but declares that it does not follow that when a tax statute, drawn to operate prospectively as to transactions in the future, employs as to interest the word "payable," this excludes interest that is not only payable but is also paid (R. 77; 168 F. 2d 402).

As a general proposition that manifestly may be true or untrue in any given instance, depending entirely upon the

manner in which the word "payable" is employed in the particular instance, its context, the time to which it relates, and the purpose of the provision and enactment in which it appears. That the proposition is wholly inapposite here has been fully demonstrated above (*supra*, pp. 11-14). For the reasons there assigned it does in this instance most certainly follow that interest already paid during the taxable year is not interest that "is payable" within the meaning of the proviso of subsection 16(a)(2), and that the statute cannot logically or legally be otherwise construed.

Pursuing the discussion introduced by the proposition last above mentioned, the Circuit Court of Appeals proceeds thus (R. 77; 168 F. 2d 402):

> "Surely interest that is payable during a certain tax year, will according to good commercial practice and ethics, actually be paid during that year. Normally and naturally, interest 'capable of being paid', or 'to be paid' will be paid during the year in which it is due. Appellant's contention thus lacks reality even under the pure analytical approach."

From petitioner's viewpoint, it is the reasoning last quoted that lacks reality. It is common knowledge that accrued interest is not always paid in the year in which it accrues. Everybody knows that deferments and defaults in the payment of interest, as well as other debts, are not uncommon, and are sometimes unavoidable. The very statute under consideration, in the introductory clause of subsection 16(a)(2), expressly makes general provision for the deduction of all interest "paid or accrued", thus plainly contemplating that some interest accrued and thus becoming due or at least payable during a tax year may not be paid during that year, and will remain in the category of interest due or accrued and therefore still payable, upon computation of net income at the end of that tax year.

Next in its opinion the learned Circuit Court of Appeals, although first remarking the noticeable lack here of direct authority, nevertheless quotes as "significant" certain

parts of the opinion of the Sixth Court of Appeals in *Carlisle* v. *Commissioner of Internal Revenue,* 165 F. 2d 645 (R. 77-78; 168 F. 2d 402).

A brief examination of that case will disclose that it affords no support whatever for the view of the lower appellate courts in this case, to the effect that the words "if it is payable" in the proviso under scrutiny here may be construed to mean also "if it is paid", or anything else deemed inclusive of interest actually paid during the tax year.

The statute construed in the *Carlisle* case was section 162(b) of the federal Internal Revenue Code, as amended in 1942 [26 U. S. C. Int. Rev. Code, Sec. 162(b)], allowing trustees in computing the net incomes of their estates or trusts for income tax purposes to deduct the amounts of the income of each trust or estate for its taxable year *which is to be distributed currently* by the fiduciary to the legatees, heirs or beneficiaries, providing that the amount so deducted shall be included in computing the net income of the legatees, heirs or beneficiaries whether distributed to them or not, and then providing further (italics supplied):

> "As used in this subsection, 'income which is to be distributed currently' includes income for the taxable year of the estate or trust *which, within the taxable year, becomes payable to the legatee, heir or beneficiary.*"

The question there was whether the provision above quoted encompassed income that not only had become payable during the tax year to a legatee, but had actually been paid during that year to the legatee. The question was answered in the affirmative, but the wide distinction between the wording of the statute there involved, and the wording of the statute in question here, is apparent at a glance.

If the insular statute in controversy here had forbidden the deduction of interest "which within the taxable year *becomes payable* between members of one family", peti-

tioner would not be charging inescapable error of local law in the disallowance of the deductions here involved. However, the statute here says no such thing. On the contrary, it prohibits the deduction of interest only "if it is payable", etc., and, as already noted, the quoted words are expressly by their context related to the end of the tax year.

The gist of that part of the opinion of the Circuit Court of Appeals in the present case relating to the question of local law, appears to lie in the following extract, to wit (R. 78; 168 F. 2d 402-3):

> "Appellant's contention we think, has even less merit when the statute is interpreted in the light of its manifest purpose—the denial of deductions for interest paid by one member of a family to another. Then, it would seem, it was the manifest purpose of the legislature here to match precisely the exclusion to the grant—that is, by permitting as a general rule the deduction of interest on indebtedness yet to deny this deduction when the interest is paid "between members of one family."

Yet we find nothing in this passage, or in what precedes or follows it, to explain *why* that court believes the purpose of the legislature here to be as stated. On the other hand, in a paragraph immediately following that last above quoted, the court expressly declares that the wording of the statute is inept, and points out how the purpose of excepting paid interest as well as unpaid from the general authorization could easily have been definitely expressed by certain indicated and substantial modifications of the language.

In our opinion, the language of the proviso is patently worse than merely inept for such a purpose; it is not reasonably susceptible of interpretation as evidencing such a purpose at all.

The language of the proviso is inept only if the appellate courts below are correct in their unexplained view that its purpose was contrary to the usual acceptance and usage of

its terms. Taken in the ordinary sense of its words and context, its purpose is clear, entirely harmonious, and well expressed. Certainly the conceded ineptitude of its terms to express the purpose ascribed by the lower appellate courts, is in itself a very strong, if not conclusive, indication that no such purpose existed. The real purpose of the proviso was, as clearly expresed by its terms, to exclude from the generally authorized deductions of interest, only interest accrued between relatives and others within the indicated groups, not actually paid during the tax year, substantially as had been done by the Congress in corresponding earlier federal income tax legislation above mentioned (*supra*, pp. 15-16).

But the Court of Appeals proceeds (R. 79; 168 F. 2d 403):

> "Yet we must not be deflected from our manifest duty of giving to the statute a fair and practical interpretation by mere inept legislative draftsmanship."

No one could object to that statement as a general abstraction, nor to any of the various authorities quoted thereunder to the effect that the purpose of an enactment controls its interpretation. However, it should be observed that the same authorities expressly recognize the well established corollaries that the words used, even in their literal sense, are the primary, and ordinarily the most reliable, source of determining the meaning of any writing: be it a statute, a contract, or anything else (*Cabell* v. *Markham*, 148 F. 2d 737, 739); and that departure from the ordinary sense of the wording of a statutory provision to make its interpretation accord with an assumed purpose can be justified only when that purpose is "sufficiently disclosed" (*Federal Deposit Insurance Corporation* v. *Tremaine*, 135 F. 2d 827, 830). Incidentally, as indicated above (pp. 17-18), those corollaries are in substance made mandatory in Puerto Rico by local statute.

Obviously the passage last above quoted was designed as a justification of the court's refusal to follow the literal terms of the statute, despite its frankly expressed view that the wording was inept for the intent and purpose arbitrarily ascribed to the measure by the court, but the passage fails of that mission because it only carries forward an argument based wholly upon the initial bald assumption that the legislature meant something quite different from what it literally said, without suggesting the slightest reason for that assumption.

One further feature of that part of the lower court's opinion devoted to the question of the meaning of the statute as a matter of local law, calls for our comment. We refer to the statement (R. 79; 168 F. 2d 403):

> "Our views, too, are supported by other sections of this taxing statute which are in pari materia."

We think it probable that this relates to an argument advanced by the respondent in the lower court to the effect that petitioner's interpretation of the proviso of subsection 16(a)(2) is wrong, because in the same Act No. 31 of 1941 by which that proviso was inserted, the legislature also added two other restrictive provisos to the preceding subsection 16(a)(1), relating to deductions of business expenses, in which other provisos, as respondent contended, the legislature used more explicit terms to indicate its intentions to withhold or extend the application of the prescribed restrictions.

The pertinent part of the text of subsection 16(a)(1), with the cited provisos in italics, is in Appendix A, *infra*, pp. 42-43.

The fact that the legislature apparently attempted, whether successfully or not we think very doubtful, to define its intentions more explicitly in its provisos affecting the broader subject of the deductibility of business expenses in general, than in the proviso with which we are

concerned here affecting the narrower subject of the deduction of interest payments, affords no logical ground for disregarding the literal, plain and unambiguous terms of the latter.

The first of the cited provisos of subsection 16(a)(1), by virtue of its use of the disjunctive between its first and second clauses, appears literally to repeal by necessary implication the general authorization of the unchanged preceding text of the subsection for the deduction of "incurred" expenses, by denying deduction of any incurred expenses not really paid. It is rendered still further ambiguous by its peculiar employment in its first clause, of the condition "if not really paid during the taxable year", and its repetition of substantially the same condition at the end of the second clause.

The second proviso denies deduction of expenses, "if at the close of the taxable year of the taxpayer the latter and the person or corporation to whom such payments are to be made," are related or associated in specified ways. Respondent insisted that the expense deduction is denied under this proviso, even if really paid during the taxable year, but cited no authority for that conclusion, while the express references in the proviso to the close of the taxable year, and to the indicated payments as those which "are to be made", seem necessarily to imply that the proviso relates only to expenses incurred during the taxable year not actually paid before the end thereof.

Thus it appears that these allegedly more explicit provisos, when considered together, and in conjunction with the retained original text of their subsection, are really self-contradictory and otherwise ambiguous. Certainly they afford no justification whatever for judicially writing into the proviso of subsection 16(a)(2) a meaning wholly outside its literal terms, beyond any reasonable inference arising therefrom or from anything else in the act, and in conflict with the basic purposes of the act.

Accordingly we conclude as to our Point I, that it is well founded in every respect, and that it calls both for the granting of the foregoing petition, and for reversal of the judgment of the Circuit Court of Appeals.

Point II.

The Uniformity of Taxation Clause of the Puerto Rican Organic Act Requires Intrinsic Uniformity.

The uniformity of taxation clause of the Organic Act reads as follows (par. 22, section 2, Act of March 2, 1917, 39 Stat. 951, as amended by the Act of May 17, 1932, 47 Stat. 158; 48 U. S. C. 737):

> "That the rule of taxation in Puerto Rico shall be uniform."

Similar provisions generally found in state constitutions have been with practical unanimity interpreted by state courts as applying to the intrinsic nature of the tax and its operation on individuals. *Knowlton* v. *Moore,* 178 U. S. 41, 87, 20 S. Ct. 747, 44 L. Ed. 969.

After prior decisions clearly predicated upon an understanding that the clause required intrinsic uniformity (For example: *Domenech* v. *Havemeyer,* 49 F. 2d 849, 852), the Court of Appeals first expressed a different view in *Ballester-Ripoll* v. *Court of Tax Appeals* (1944), 142 F. 2d 11. Two years later, in *South Porto Rico Sugar Co.* v. *Buscaglia, supra,* 154 F. 2d 96, 100, without intermediate ruling on the question, the same court declared it well settled that the uniformity provision exacts only geographical and not intrinsic uniformity. In the latter case, however, the court made no reference to its previous holding to that effect, and cited only opinions of this court so construing the federal constitutional uniformity clause, beginning with *Knowlton* v. *Moore, supra.*

Now, in its opinion in this case, the Court of Appeals has rejected petitioner's plea for a reconsideration of that

view, simply repeating its declaration to the effect that that view is well settled, and quoting with approval from *South Porto Rico Sugar Co.* v. *Buscaglia, supra,* to the same effect (R. 80).

Meanwhile, in 1932, following the decision of the Court of Appeals in *Domenech* v. *Havemeyer, supra,* holding Section 17 of the Puerto Rican Income Tax Act of 1921 unconstitutional for lack of intrinsic uniformity, the insular Supreme Court adopted the same view in *Loiza Sugar Co.* v. *Domenech,* 43 P. R. R. 855. And it is a matter of verifiable fact and common knowledge, of which this court may properly take judicial notice, that the insular legislature has always evinced the same understanding, always taking pains to avoid lack of intrinsic uniformity in its taxing statutes, its few failures to do so in matters of detail having obviously been due to inadvertence rather than intent.

In the *Ballester-Ripoll case,* the Court of Appeals based its conclusion that the Puerto Rican uniformity clause means only geographical and not intrinsic uniformity, very largely upon the *Knowlton case, supra.* The reasoning of that court was in brief that because this court in the *Knowlton* case held the federal constitutional uniformity clause regarding duties, imports and excises to mean only geographical uniformity, it was reasonable to suppose that the Congress meant the same thing by the uniformity clause of the Puerto Rican Organic Act covering all local taxation.

But that reasoning involves an obvious *non sequitur,* because of the significant differences of wording and purpose between the two clauses. It was the similar difference of wording between the federal and state constitutional provisions, that is, the presence of the words "throughout the United States" in the federal clause, and the absence of corresponding geographic expression from the state clauses, on which this court in the *Knowlton* case largely based its conclusion.

Other considerations upon which the ruling in the *Knowlton* case was predicated were, the history of the fed-

eral constitutional uniformity clause, and its cognate relation to the clause in Section 9 of Article I prohibiting preferences among the ports of the different states. Obviously these other considerations, like that previously mentioned, are wholly inapposite to the question of the intent of the Organic Act uniformity clause, which presents no corresponding factors.

On the other hand, a brief examination of the *Knowlton* case will show that, as above indicated, this court in that case clearly recognized the existence of uniformity of taxation clauses in many state constitutions, and the practical unanimity of their interpretation by state courts as applying to the intrinsic nature of the tax and its operation upon individuals (178 U. S. 41, 84-88).

In other words, when this court decided the *Knowlton* case in 1900, it expressly recognized the general understanding of the unqualified word "uniform" in state constitutional uniformity of taxation provisions as including intrinsic uniformity, and a major part of the opinion in that case is devoted to clarification of the distinctions between the federal clause and the state clauses. The plain inference is that but for the presence in the federal clause of the words "throughout the United States", and the other distinctions mentioned, this court would have held that the federal clause, like the state clauses, requires intrinsic uniformity.

Thus it follows logically that when, seventeen years later, in formulating the uniformity clause for Puerto Rico, the Congress omitted the significant word "throughout" embodied in the federal uniformity clause, and made the language conform substantially to that of corresponding clauses in many state constitutions construed to require intrinsic uniformity, that body did so with deliberate intent to require intrinsic as well as geographic uniformity of taxation in Puerto Rico.

And it follows that the Court of Appeals erred manifestly in its opinion in the *Ballester Ripoll* case in saying (142 F. 2d 18):

> "It is reasonable to suppose that when Congress carried over the requirement of uniformity in taxation from the Constitution into the Organic Act of Puerto Rico it intended the same meaning for the term that it had always attributed to it in the passing of legislation for continental United States and that had been applied in the courts."

The error in that statement lies first in its assumption that Congress carried the uniformity clause over from the Constitution of the United States without change into the Organic Act. That, of course, is not true. As already shown, the Organic Act provision differs from the Constitutional provision in the same vital particulars by which this court distinguished the federal clause from the state clauses in the *Knowlton* case.

The last above quoted statement is also manifestly erroneous in its inference that the unqualified word "uniform" in uniformity of taxation clauses had been construed by the courts to mean only geographical uniformity.

The Organic Act uniformity clause applies to all local taxation and not merely duties, imposts and excises, contains no language corresponding to "throughout the United States" in the special sense in which that phrase was interpreted in the *Knowlton* case, was enacted for a single small insular territory and not for the nation, and conforms in text more nearly to the corresponding state constitutional provisions than the federal. It is logical to conclude that the state constitutions were the source of the provision, and that it was intended to place Puerto Rico on a parity with the states in this important regard. It is utterly illogical to conclude that Congress intended to make of the island possession the sole state or territorial jurisdiction with a comparable uniformity of taxation clause, in which the people could claim protection under that clause only against geographical discrimination of local taxation, and might, so far as that clause is concerned, be subjected to the gravest injustices in the distribution of the tax burden intrinsically.

We conclude, as to the uniformity clause of the Organic Act, that it clearly requires intrinsic uniformity as well as geographic, that its long standing original interpretation to that effect by the Court of Appeals, the Supreme Court of Puerto Rico, and the insular legislature, should be restored, and that it should be held to bar and invalidate the grossly unequal, unfair, capricious and confiscatory application of the Puerto Rican income tax act attempted in this case.

Point III.

The Judgments of the Supreme Court of Puerto Rico and Circuit Court of Appeals Are Also Clearly Erroneous as a Matter of Federal Law.

In considering the questions whether subsection 16(a), as construed and applied by the respondent and by the insular Supreme Court in this case, offends the due process, equal protection and uniformity of taxation guaranties of the Organic Act, it is well to begin with a survey of the practical effect of the statute as so construed and applied.

Generally, with minor exceptions not pertinent here, the statute gives every natural person the right to exclude from his net income, and therefore to be entirely free from taxation upon, all parts of his gross income which he has actually paid out during the taxable year as interest upon his own indebtedness.

However, the proviso of that subsection, as construed and applied by the respondent and the insular Supreme Court, would deny that right to every such taxpayer to the extent of any interest paid to any member of his own family, even in cases where, as in the present case, the contract under which the interest was paid antedated enactment of the proviso, and the taxpayer thus had no option to exclude himself from the application of the proviso.

So the effect of the taxing statute, thus construed and applied, is to set up a primary classification of interest pay-

ing taxpayers, exempt them generally from taxation on interest paid, and then to attempt to carve out of that general class, a subclassification based solely on family relationship between the taxpayer and his interest payee, and to withhold the exemption from members of the subclass.

The respondent is demanding from petitioner over $9,000 more in income taxes than he would or could lawfully collect from any other taxpayer with the same gross income, the same exemptions and deductions other than interest paid, and the same total amount of interest paid, but whose interest payments had been made exclusively to others than members of his own family.

Expressed otherwise, the petitioner is in effect being called upon to pay for the privilege of having dealt with his two brothers, in addition to the interest contracted and paid, a penalty in taxes of more than $9,000.

And, again in this connection, it must be borne in mind that we are not concerned, in this case, with fraudulent or fictitious transactions, or any attempt by the taxpayer to escape ordinary tax liability by juggling accounts or methods of accounting, or with a situation where the taxpayer had any chance to elect whether to enter or keep out of the interest non-deductible classification or subclassification. The record shows beyond question that the transactions and indebtedness were genuine, and were contracted in good faith mostly in 1940 before the proviso in question was enacted; and that the interest became legally due, was actually paid during the taxable year, and was duly reported by the payees on their returns for the same year.

Under similar circumstances, with relation to the corresponding federal income tax provisions, the Circuit Court of Appeals for the Fifth Circuit upheld the validity of taxpayers' deduction of interest paid to their own children, against a contention that the basic transaction had been designed merely to avoid taxes, declaring (*Montgomery* v. *Thomas* (1944), 146 F. 2d 76, 81):

"The general rule is in accord with that expressed in Johnson v. Commissioner of Internal Revenue, 2 Cir., 86 F. 2d 710:

'Legal transactions cannot be upset merely because parties have entered into them for purpose of minimizing or avoiding taxes which might otherwise accrue.'

"Nothing done by appellants was illegal. There is no evidence of any sham or any fraud. Everything done was real. The Commissioner's determination that the income received by appellants' children during the years referred to was taxable to appellants was erroneous, and the deficiency assessments based thereon are without support in law."

In the present case, the attempted subclassification not only is based on no real or substantial difference or distinction properly related to, but is actually inconsistent with the nature and purposes of net income taxation. The resulting discrimination is arbitrary, unreasonable and capricious. The deficiency tax imposed is confiscatory, unequal, unjust, lacking in uniformity, and deprives the taxpayer of property without due process of law, and of the equal protection of the laws, all in violation of the Organic Act.

The due process clause of the Fifth Amendment, prescribing that no person shall be deprived of life, liberty or property without due process of law, probably extends of its own force to Puerto Rico. *Thornberg* v. *Jorgensen*, 60 F. 2d 471, 473. However, we are not concerned with that question here, for the terms of the guaranty are expressly made applicable in Puerto Rico by verbatim inclusion in the first paragraph of section 2 of the Organic Act (Act of March 2, 1917, section 2, 39 Stat. 951; 48 U. S. C. 737).

And the equality clause of the 14th Amendment, forbidding any State to deny to any person within its jurisdiction the equal protection of the laws, has likewise been expressly extended by Congress to Puerto Rico by inclu-

sion of its terms in the same first paragraph of section 2 of the Organic Act.

It follows that authoritative judicial opinions construing the due process and equal protection clauses of the federal Constitution, are equally applicable to the corresponding provisions of the Puerto Rican Organic Act.

Due process of law demands that a law shall not be unreasonable, arbitrary or capricious. *Minski* v. *United States,* 131 F. 2d 614, 617; affirmed *Tot* v. *United States,* 319 U. S. 463, 63 S. Ct. 1241, 87 L. Ed. 1519.

The principle that a taxing statute which is so arbitrary as to amount to a confiscation or a clear and gross inequality or injustice, is invalid under the due process clause of the Puerto Rican Organic Act, was recognized by the First Circuit Court of Appeals as recently as March 6, 1946, in *South Porto Rico Sugar Co.* v. *Buscaglia,* 154 F. 2d 96, 100. And where a statute makes an arbitrary discrimination between persons in similar circumstances and conditions there is denial of both equal protection of the law and due process of law. *Wallace* v. *Currin,* 95 F. 2d 856, 866-7, affirmed *Currin* v. *Wallace,* 306 U. S. 1, 59 S. Ct. 379, 83 L. Ed. 441. In order to satisfy those guaranties, a classification for taxation must be reasonably related to the object of the legislation and must be based upon some distinction which can rationally and fairly be made the reason for different taxation. *Schlesinger* v. *Wisconsin,* 270 U. S. 230, 240, 46 S. Ct. 260, 70 L. Ed. 557; *Colgate* v. *Harvey,** 296 U. S. 404, 423, 56 S. Ct. 252, 80 L. Ed. 299; *San Juan Trading Co.* v. *Sancho,* 114 F. 2d 969, 971; certiorari denied 312 U. S. 702.

In *Heiner* v. *Donnan* (1932), 285 U. S. 312, 322-332, 52 S. Ct. 358, 76 L. Ed. 772, this court declared unconstitutional for lack of due process the provision of section 302(c) of the Revenue Act of 1926 (44 Stat. 70), purporting to

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* Although this case was overruled in part in *Madden* v. *Kentucky,* 309 U. S. 83, 93, 60 S. Ct. 406, 84 L. Ed. 590, the principle to which it is here cited was not disturbed by the latter decision.

establish, for the purposes of the federal estate tax, a conclusive presumption of fact that gifts made by a decedent within two years prior to his death were made in contemplation of death, and thus requiring that the values of such gifts be included in the gross value of the estate. The reasoning was in substance that the mentioned statutory provision was arbitrary, capricious, unjustly discriminatory, and wholly without logical relation to the purposes of the enactment of which it was a part.

Excess profits provisions of a Puerto Rican income tax act were held by the First Circuit Court of Appeals to be violative of the uniformity of taxation clause of the Organic Act because of arbitrary discrimination as to rates of taxation between taxpayers in like circumstances. *Domenech* v. *Havemeyer, supra.*

Next we wish to comment upon the suggestion advanced by the Court of Appeals in support of the validity of the separate corporate income tax classifications and discriminatory rates sustained in the *South Porto Rico Sugar Company case, supra,* to the effect that the purpose of the classification may well have been to facilitate the administration of the tax laws (154 F. 2d 100). Attention is invited to the fact that the court took pains in that case to point out substantial differences in the situations of the two classes of corporations there involved, tending to render the discrimination reasonable and proper.

No such differences exist between the classes of taxpayers involved in the present case, wherein the sole difference between the groups of taxpayers separately classified is the existence of a family relationship to payees of interest on the part of members of the group against which the discrimination is imposed, and the absence of such relationship on the part of members of the favored group.

Furthermore, we find nothing in the pertinent judicial precedents which would sustain a view that substantial, unreasonable and capricious inequality and injustice in the operation or application of a taxing statute can be

excused by the courts upon the sole ground that the inequality and injustice are designed to lighten the task of the tax collector. On the contrary, it is inherent in the very essence of the fundamental guaranties of due process, equal protection and uniformity of taxation, that substantive provisions of taxing statutes, designed to facilitate administration, must themselves also conform to the requirements of those guaranties.

In *Schlesinger* v. *Wisconsin, supra,* in which this court held unconstitutional for lack of due process and equal protection a state taxing act provision, the court said (270 U. S. 240):

> The presumption and consequent taxation are defended upon the theory that, exercising judgment and discretion, the legislature found them necessary in order to prevent evasion of inheritance taxes. That is to say, "A" may be required to submit to an exactment forbidden by the Constitution if this seems necessary in order to enable the State readily to collect lawful charges against "B." Rights guaranteed by the federal Constitution are not to be so lightly treated; they are superior to this supposed necessity. The State is forbidden to deny due process of law or the equal protection of the laws for any purpose whatsoever.

The foregoing holding was cited and followed in *Hoeper* v. *Tax Commission,* 284 U. S. 206, 216-217, 52 S. Ct. 120, 76 L. Ed. 248, and *Heiner* v. *Donnan, supra,* 285 U. S. 312, 324-326.

Of course it may be suggested that the proviso of subsection 16(a)(2) of the Puerto Rican income tax law with which we are concerned here, as construed by the insular treasurer and Puerto Rican Supreme Court, might have been designed to make the treasurer's job a little easier, by rendering it unnecessary for him and his agents to inquire, as they must do in other instances, into the genuineness of interest bearing obligations upon which the taxpayer claims

to have paid interest to members of his own family, enabling the treasurer in such circumstances simply to overrule the deduction and charge and collect the additional tax without regard to the genuineness of the transactions.

But that theory, if sound, would detract nothing from, indeed would only add to, the arbitrariness, unreasonableness and capriciousness of the discrimination, for certainly there appears to be no plausible reason why the tax collector should be spared, with relation to one special limited group of interest-paying taxpayers, and at such heavy expense to the latter, pains which he must take with relation to all other taxpayers reporting paid interest deductions.

With respect to unpaid interest, deducted by the taxpayer upon an accrual basis, not reported or required to be reported by the payee as income for the same year, there may perhaps be reasonable administrative grounds for a statutory denial of the deduction where it is claimed the interest is payable to a relative, or to a corporation controlled by the taxpayer. But certainly where, *as in the present case, the interest has actually been paid in good faith during the taxable year to payees who reported it as income for the same year,* the fact, where it is a fact, that the payees are relatives of the taxpayer makes no logical difference whatever, properly related to or consistent with the nature, purpose or administration of net income taxation.

In support of its construction of the taxing law in this case, the insular Supreme Court refers to the principle that deductions, like exemptions, are a matter of legislative grace, and should be construed strictly against the person claiming them (R. 29). That principle has no proper application in this case.

With relation to the question of local law above discussed, that is, whether the insular legislature intended by the word *payable* in the proviso under consideration to refer to interest actually paid during the taxable year, the rule of strict construction to which the insular Supreme refers, has no

bearing whatever. As already shown (*supra*, pp. 17-18) it is fundamental that recourse to such rules is available only where there is ambiguity. Where, as in this instance, the language of a statutory provision is clear and unambiguous, and there is nothing in the entire act in which it appears to indicate a different intent, the provision is construed and enforced according to its literal terms.

The correct rule was well restated by the Ninth Circuit Court of Appeals in *Wallace* v. *Commissioner of Internal Revenue, supra,* as follows (144 F. 2d 410):

> "The plain, obvious and rational meaning of a tax statute is always to be preferred to any narrow or hidden sense that nothing but the exigency of a hard case justifies, and while the meaning to be given to terms used will be determined from the character of their use by the legislature in the statute under consideration, words in common use should not be distorted by administrative or judicial interpretation."

As to the federal questions presented, the matter of strict or liberal construction of the insular taxing statute even more obviously is not a factor, because those questions relate to the taxing statute as construed "strictly" by the insular Supreme Court, and challenge the validity of that construction as violative of the fundamental guaranties of the Organic Act.

To the foregoing argument, so far as concerns due process and equal protection, the Circuit Court of Appeals replies rather summarily in substance that the claim of invalidity is without any warrant, because "many places in federal tax statutes take cognizance of the close identity of economic interests within the family", and because close scrutiny, for income-tax purposes, is always given by the Courts to intra-family transactions (R. 81; 168 F. 2d 404).

But here again we are confronted by an obvious *non sequitur*. It is true of course that federal income tax statutes discriminate in some particulars against intra-family transactions, and that such discriminations have in

some instances been upheld by the courts against complaints of lack of due process or equal protection. However, it certainly does not follow that all such discriminations are valid. It is no answer to specific charges of discrimination and injustice, such as are presented by this case, to cite instances where courts have failed to sustain such charges in other cases involving different statutes, facts and circumstances.

Surely there is some limit beyond which legislatures and tax collectors cannot go in tax discriminations predicated solely on family or other relationships, without regard to the reality and good faith of the transactions involved. And surely that limit is passed where, as in the present case, if the law be construed as it was by the appellate courts below, it in effect inflicts a penalty of more than $9,000 upon a taxpayer for having actually, lawfully and in good faith paid to his brothers, interest due on genuine obligations contracted in large part before the taxing statute was amended to read as so construed.

Finally we invite attention to the fundamental principle that where a statute is susceptible of two interpretations, by one of which grave and doubful constitutional questions arise and by the other of which such questions are avoided, the latter interpretation is adopted. *Harriman* v. *Interstate Commerce Com.*, 211 U. S. 407, 29 S. Ct. 115, 53 L. Ed. 253, cited with approval in *United States* v. *Congress of Industrial Organizations*, 68 S. Ct. 1349, 1346, note 20. Other cases recognizing the same principle are *Crowell* v. *Benson*, 285 U. S. 22, 62, 52 S. Ct. 285, 296, 76 L. Ed. 598, and *Ashwander* v. *Tennessee Valley Authority*, 297 U. S. 288, 348, 56 S. Ct. 466, 484, 80 L. Ed. 688.

We think this court will readily agree that the questions above discussed under this Point III, are at least substantial, grave and doubtful. In principle, they are questions of the constitutionality of the statute as interpreted by the appellate courts below. It is apparent also that those questions can be wholly avoided by adopting the alternative

interpretation advocated by the petitioner, and upheld by the insular Tax Court, that is, the simple, plain, literal meaning of the words of the statute.

CONCLUSION.

The writ should be granted, and in due course the judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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APPENDIX A.

FULL TEXT OF THAT PART OF SUBSECTION 16A, OF ACT NO. 74, APPROVED AUGUST 6, 1925, AS AMENDED BY SECTION 8 OF ACT NO. 31, APPROVED APRIL 12, 1941 (LAWS OF P. R., 1941, PP. 478, 494-496), INCLUDING NUMBERED SUBDIVISIONS (1) AND (2). ITALICS ARE SUPPLIED TO INDICATE PROVISOS INSERTED BY ACT NO. 31.

"Section 16.—(a) In computing net income there shall be allowed as deductions:

"(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; travelling expenses (including the entire amount for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity; *Provided, That such expenses, salaries, rentals, or payments shall not be deductible if not really paid during the taxable year or if, under the system of accounting used by the person to whom such payments are to be made, the amount has not been included in his gross income during the taxable year, unless they have not really been paid; Provided, further, That such expenses or payments shall not be deductible if, at the close of the taxable year of the taxpayer, the latter and the person or corporation to whom such payments are to be made, are persons or corporations who:*

"(*a*) *Are members of the same family; or* (*b*) *are an individual or a corporation with respect to which the individual is the direct or indirect owner of more than fifty* (*50*) *per cent of the value of the outstanding stock; or* (*c*) *are two corporations with respect to which one same individual or corporation is the direct or indirect owner of more than fifty* (*50*) *percent of the value of the out-*

standing stock of each of said corporations; or (d) are two corporations, one of which is the direct or indirect owner of more than fifty (50) per cent of the outstanding stock of the other corporation. For the purposes of this section an individual shall be considered as owner of the shares which belong directly or indirectly to his family; and by family shall be understood, for the purposes of this paragraph, relatives up to the fourth degree of consanguinity and affinity; Provided, That the payments made by a corporation under title of salaries to its officers, stockholders or relatives of stockholders when they control over fifty (50) per cent of the outstanding stock, are not ordinary or necessary expenses if such payments are not proportionate to the reasonable value of the services rendered by said stockholders or officers, or if the amount of said payments is excessive;

"(2) All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred, or continued, to purchase or carry obligations title or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; *Provided, That no interest is deductible if it is payable between members of one family or between an individual and a corporation with respect to which the individual is the direct or indirect owner of more than fifty (50) per cent of the value of the outstanding stock; or (c) between corporations with respect to which one same individual or corporation is the direct or indirect owner of more than fifty (50) per cent of the outstanding stock of each of said corporation; or (d) are two corporations one of which is the direct or indirect owner of more than fifty (50) per cent of the outstanding stock of the other corporation."*

APPENDIX B.

EXAMPLES OF PUERTO RICAN STATUTES ILLUSTRATING THE INVARIABLE USE BY THE PUERTO RICAN LEGISLATURE OF THE WORD "PAYABLE", AND ITS SPANISH EQUIVALENTS (*Pagadero, Pagadera, Pagaderos, Pagaderas*), TO DESCRIBE ONLY UNPAID OBLIGATIONS. ITALICS AND BRACKETS ENCLOSING OFFICIAL SPANISH EQUIVALENTS OF ITALICIZED WORDS ARE SUPPLIED.

Code of Commerce, Edition of 1932, Title XI, Sections 354 et seq., as enacted by Act No. 17. (Laws of P. R. 1930, pp. 172 et seq.)

Section 354. An instrument to be negotiable must conform to the following requirements:

* * * * * * * * * * *

3. *Must be payable* [*será pagadero*] on demand, or at a fixed or determinable future time;

4. Must be *payable* [*pagadero*] to order or to bearer. * * *

Section 355. The *sum payable* [*suma pagadera*] is a sum certain within the meaning of this title, although it is to be paid: * * *

Section 357. An instrument *is payable* [*será pagadero*] at a determinable future time, within the meaning of this title, which is expressed *to be payable* [*que se pagará*]: * * *

Section 360. An instrument *is payable* [*será pagadero*] on demand:

1. Where it is expressed *to be payable* [*que se pagará*] on demand, or at sight, or on presentation; or

2. In which no time for payment is expressed.

Where an instrument is issued, accepted, or indorsed when overdue, it is, as regards the person so issuing, accepting, or indorsing it, *payable* [*pagadero*] on demand.

Section 362. The instrument *is payable* [*será pagadero*] to bearer:

1. When it is expressed to be so payable; or

2. When it *is payable* [*es pagadero*] to a person named therein or bearer; or

3. When it *is payable* [*es pagadero*] to the order of a fictitious or non-existing person * * *

Section 366. Where an instrument expressed to be *payable* [*pagadero*] at a fixed period after date is issued undated, or where the acceptance of an instrument *payable* [*pagadero*] at a fixed period after sight is undated, any holder may insert therein the true date of issue or acceptance and the instrument shall be *payable* [*pagadero*] accordingly. * * *

Section 378. * * * An antecedent or preexisting debt constitutes value; and is deemed such whether the instrument is *payable* [*pagadero*] on demand or at a future time.

Section 383. * * * If *payable* [*pagadero*] to bearer it is negotiated by delivery; if *payable* [*pagadero*] to order it is negotiated by the indorsement of the holder completed by delivery.

Section 387. A special indorsement specifies the person to whom, or to whose order, *the instrument is to be payable* [*ha de pagarse el documento*]; * * * An indorsement in blank specifies no indorsee, and an instrument so indorsed is *payable* [*pagadero*] to bearer * * *

Section 394. Where an instrument is *payable* [*pagadero*] to the order of two or more payees or indorsees who are not partners, all must indorse * * *

Section 395. Where an instrument is drawn or indorsed to a person as "Cashier" or other fiscal officer of a bank or corporation, it is deemed prima facie to be *payable* [*pagadero*] to the bank or corporation * * *

Section 406. Where an instrument *payable* [*pagadero*] on demand is negotiated an unreasonable length of time after its issue, the holder is not deemed a holder in due course.

Section 417. Where a person, not otherwise a party to an instrument, places thereon his signature in blank before delivery he is liable as indorser, in accordance with the following rules:

1. If the instrument is *payable* [*pagadero*] to the order of a third person, he is liable to the payee and to all subsequent parties.

2. If the instrument is *payable* [*pagadero*] to the order of the maker or drawer, or is *payable* [*pagadero*] to bearer, he is liable to all parties subsequent to the maker or drawer. * * *

Section 423. * * * but, if the instrument is, by its terms, *payable* [*pagadero*] at a special place * * *

Section 424. Where the instrument *is not payable* [*no es pagadero*] on demand, presentment must be made on the day it falls due. * * *

Section 428. Where the instrument is *payable* [*pagadero*] at a bank, presentment for payment must be made during banking hours, * * *

Section 438. Every negotiable instrument is *payable* [*pagadero*] at the time fixed therein without grace. * * *

Section 439. Where the instrument is *payable* [*pagadero*] at a fixed period after date, sight, or after the happening of a specified event, the time of payment is determined by excluding the day from which the time is to begin to run, and by including the date of payment.

Section 440. Where the instrument is made *payable* [*pagadero*] at a bank it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon.

Section 474. Where the instrument is paid by a party secondarily liable thereon, it is not discharged; but the party so paying it is remitted to his former rights as regards all prior parties, and he may strike out his own and all subsequent indorsements, and again negotiate the instrument, except:

1. Where it is *payable* [*pagadero*] to the order of a third person, and has been paid by the drawer; * * *

Section 478. Any alteration which changes:

1. * * *

2. The *sum payable* [*cantidad pagadera*], either for principal or interest;

Section 482. An inland bill of exchange is a bill which is, or on its face purports to be, both drawn and *payable* [*pagadera*] within Puerto Rico. * * *

Section 491. * * * But when a bill *payable* [*pagadera*] after sight is dishonored by non-acceptance * * *

Section 496. Presentment for acceptance must be made:

1. Where the bill is *payable* [*pagadera*] after sight * * *

2. * * *

3. Where the bill is drawn *payable* [*ser pagada*] elsewhere than at the residence or place of business of the drawee. * * *

Section 509. A bill must be protested at the place where it is dishonored, except that when a bill drawn *payable* [*pagadera*] at the place of business, or residence of some person other than the drawee, has been dishonored by non-acceptance, it must be protested for non-payment at the place where it is expressed to be *payable* [*pagadera*] * * *

Section 519. Where a bill *payable* [*pagadera*] after sight is accepted for honor, its maturity is calculated from the date of the noting for non-acceptance * * *

Section 538. A check is a bill of exchange drawn on a bank *payable* [*pagadera*] on demand. Except as herein otherwise provided, the provisions of this title applicable to *a bill of exchange payable* [*letras de cambio pagaderos*] on demand apply to a check.

Section 543. In this title, unless the context otherwise requires: * * *

"Bearer" means the person in possession of a bill or note which is *payable* [*pagadero*] to bearer.

Civil Code, Edition of 1930

Section 1153. *Debts payable* [*Las deudas pagaderas*] in different places may be compensated by an indemnity for the expenses of transportation or for the exchange at the place of payment.

Political Code, Section 85, as Amended by Act No. 65, May 5, 1945 (Laws of P. R., 1945, p. 242).

Section 85. * * * When the draft *is payable to* [*estuviere extendido a favor de*] a firm or partnership, it must be indorsed in the name of such firm or partnership by an active partner thereof; when *payable to* [*a favor de*] a company or corporation * * *

Income Tax Act No. 74, August 6, 1925, Section 65(b) (Laws of P. R., 1925, p. 530).

(b) * * * The Treasurer may approve and accept in like manner security for return and payment of taxes made *due and payable* [*vencidas y pagaderas*] by virtue of the provisions of this section * * *

Act No. 1, March 25, 1931 (Laws of P. R., 1931, p. 132)

Section 3. The principal of said promissory notes, as well as the interest thereon, shall be *payable* [*pagaderos*] in the office of the Treasurer * * *

Act No. 29, April 18, 1936 (Laws of P. R., 1936, pp. 230, 232)

Section 2. * * * The bonds may be in coupon form *payable* [*pagaderos*] to bearer * * *.

Section 4. * * * all the bonds authorized hereby shall be *payable* [*pagaderos*] solely from the revenues derived * * *.

Act No. 153, May 6, 1940 (Laws of P. R., 1940, pp. 916-918)

Section 2. * * * The bonds can be in coupon form *payable* [*pagaderos*] to bearer * * *; they shall bear interest * * * *payable* [*pagaderos*] semiannually * * *.